



STATE OF HAWAII — DEPARTMENT OF TAXATION

1995 PARTNERSHIP

Form N-20 and General Instructions

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- Schedule D (Form N-20)
- Schedule K-1 (Form N-20)
- Form N-100

DUE DATE: April 20, 1996, or the 20th day of the fourth month following the close of the taxable year.

STATE OF HAWAII — DEPARTMENT OF TAXATION

RELATED FEDERAL/HAWAII PARTNERSHIP TAX FORMS

| Federal Form Number | Title or Description of Federal Form | Use Hawaii Form | Copy of Fed. Form May Be Used* |
|--------------------------------|--|----------------------------|---|
| 970 | Application To Use LIFO Inventory Method | None | Yes* |
| 1065 | U.S. Partnership Return of Income | N-20 | No |
| Schedule D | Capital Gains and Losses | Sch. D (N-20) | No |
| Schedule K-1 | Partner's Share of Income, Credits, Deductions, Etc. | Sch. K-1 (N-20) | No |
| 1128 | Application for Change in Accounting Period | None | Yes* |
| 3115 | Application for Change in Accounting Method | None | Yes* |
| 4562 | Depreciation and Amortization | None | Yes* |
| 4797 | Sales of Business Property | Sch. D-1 | No |
| 5884 | Jobs Credit | N-884 | No |
| 6198 | Computation of Deductible Loss from an Activity Described in Section 456(c) | None | Yes* |
| 6781 | Gains and Losses from Section 1256 Contracts and Straddles | None | Yes* |
| 8283 | Noncash Charitable Contributions | None | Yes* |
| 8582 | Passive Activity Loss Limitations | None | Yes* |
| 8586 | Low-Income Housing Credit | N-586 | No |
| 8736 | Application For Automatic Extension of Time to File a Return for a U.S. Partnership or for Certain Trusts | N-100 | No |
| 8800 | Application For Additional Extension of Time to File a Return for a U.S. Partnership or for Certain Trusts | N-100A | No |
| 8824 | Like-Kind Exchanges | None | Yes* |
| 8825 | Rental Real Estate Income and Expenses of a Partnership or an S Corporation | None | Yes* |

* If there is no Hawaii equivalent form, the federal form must be used.

STATE OF HAWAII—DEPARTMENT OF TAXATION
INSTRUCTIONS FOR FORM N-20

Partnership Return of Income

(Section references are to the Internal Revenue Code (IRC) unless otherwise specified.)

Purpose of Form

Form N-20 is used to report the income, deductions, credits, gains, and losses from the operation of a partnership. Form N-20 for 1995 is an information return for the calendar year 1995 or other fiscal year beginning in 1995.

Who Must File

Every partnership unless expressly exempted shall, for its taxable year, make a return of income on Form N-20 stating specifically the items of gross income and allowable deductions, and such additional information as required below. The partnership return shall, include the income, deductions, and credits attributable everywhere together with the income, deductions, and credits attributable only to Hawaii. If the return is filed on behalf of a syndicate, pool, joint venture, or similar group which group was created on or after January 1, 1958, a copy of the agreement, together with all amendments thereto, should be attached to the return, if not already filed.

When and Where to File

The return of a partnership must be filed on or before the 20th day of the 4th month following the close of the taxable year of the partnership, with the taxation district office in which the partnership has its principal place of business. **Note:** If the due date falls on a Saturday, Sunday, or legal State holiday, the return shall be due on the next succeeding day which is not a Saturday, Sunday, or legal State holiday. Where the partnership does not have a place of business in the State, the return shall be filed with the Department of Taxation, P.O. Box 3559, Honolulu, Hawaii 96811-3559.

If you need more time to file a partnership return, file Form N-100, Application for Automatic Extension of Time to File Hawaii Return for a Partnership, Trust, or REMIC, for an automatic 3-month extension. File Form N-100 by the regular due date of the partnership return.

After you have filed Form N-100, if more time is needed to prepare the partnership return, file Form N-100A, Application for Additional Extension of Time to File Hawaii Return for a Partnership, Trust, or REMIC, for an additional extension of up to 3 months. To obtain this additional extension of time to file, you must show reasonable cause for the additional time that you are requesting. Form N-100A must be filed before the extended due date of the partnership return.

MAILING ADDRESSES

OAHU DISTRICT OFFICE
P.O. Box 3559
Honolulu, Hawaii 96811-3559

MAUI DISTRICT OFFICE
P.O. Box 913
Wailuku, Hawaii 96793-0913

HAWAII DISTRICT OFFICE
P.O. Box 1377
Hilo, Hawaii 96721-1377

KAUAI DISTRICT OFFICE
P.O. Box 1688
Lihue, Hawaii 96766-5688

DISTRICT OFFICE LOCATIONS

OAHU DISTRICT OFFICE
830 Punchbowl Street
Honolulu, Hawaii 96813-5045
Telephone: (808) 587-6515 (Jan.-April 20)
(808) 587-4242
Toll-Free: 1-800-222-3229

MAUI DISTRICT OFFICE
State Office Building
54 High Street
Wailuku, Hawaii 96793-2126
Telephone: (808) 243-5383

HAWAII DISTRICT OFFICE
State Office Building
75 Aupuni Street
Hilo, Hawaii 96720-4253
Telephone: (808) 933-4321

KAUAI DISTRICT OFFICE
State Office Building
3060 Eiwa Street
Lihue, Hawaii 96766-1310
Telephone: (808) 241-3456

Accounting Methods

Figure ordinary income by the accounting method regularly used in maintaining the partnership's books and records. Generally, permissible methods include the cash method, the accrual method, or any other method authorized by the federal Internal Revenue Code. The method used must clearly reflect income.

Generally, a partnership may not use the cash method of accounting if (a) it has at least one corporate partner, average annual gross receipts of more than \$5 million, and it is not a farming business or (b) it is a tax shelter (as defined in section 448(d)(3)). See section 448 for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year that all events have occurred that determine the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance takes place with respect to the expense. There are exceptions for recurring items.

For long-term contracts (except certain real property construction contracts), taxpayers must generally use the percentage of completion method described in section 460. However, for purposes of the percentage of completion method, the partnership may elect to postpone recognition of income and expense under a long-term contract entered into after July 10, 1989, until the first tax year as of the end of which at least 10% of the estimated total contract costs have been incurred.

Unless otherwise allowed by law, the partnership may not change the accounting method used to report income in earlier years (for income as a whole or for any material item) without first getting consent on federal **Form 3115**, Application for Change in Accounting Method. See federal **Publication 538**, Accounting Periods and Methods, for more information.

Accounting Periods

A partnership is generally required to have one of the following tax years:

1. The tax year of a majority of its partners (majority tax year); or
2. If there is no majority tax year, then the tax year of all of the partnership's principal partners (partners with an interest of 5% or more in the partnership profits or capital); or
3. If there is neither a majority tax year nor a tax year common to all principal partners, then the tax year that results in the least aggregate deferral of income; or
4. Some other tax year, if (a) the partnership can establish that there is a business purpose for the tax year (see Revenue Procedure 87-32, 1987-2 C.B. 396); or (b) the tax year is a "grandfathered" year (see Revenue Procedure 87-32); or (c) the partnership elects under section 444 to have a tax year other than a required tax year by filing federal **Form 8716**, Election to Have a Tax Year Other Than a Required Tax Year. For a partnership to have this election in effect, it must have complied with the federal requirements in making certain payments required by section 7519 and file federal **Form 8752**, Required Payment or Refund Under Section 7519.

Note: Under the provisions of section 584(h), the tax year of a common trust fund must be the calendar year.

Rounding Off to Whole-Dollar Amounts

You may show the money items on the return and accompanying schedules as whole-dollar amounts. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

Recordkeeping

The partnership records must be kept as long as they may be needed for the administration of any provision of the federal Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the partnership return must be kept for 3 years from the date the return is due or is filed, whichever is later. Keep records that verify the partnership's basis in property for as long as they are needed to figure the basis of the original or replacement property.

Copies of the filed partnership returns should also be kept as part of the partnership's records. They help in preparing future returns and in making computations when filing an amended return.

Amended Return

If, after filing its return, the partnership becomes aware of any changes it must make to income, deductions, credits, etc., it should file an amended Form N-20 and an amended Schedule K-1 for each partner. Check the box on Form N-20 at Item I(4), page 1. Give a corrected Schedule K-1 (Form N-20) to each partner. Check the box at Item I(2) on each Schedule K-1 to indicate that it is an amended Schedule K-1.

Information Returns

Every partnership must file information returns if it makes payments of rents, commissions, or other fixed or determinable income totaling \$600 or more to any one person in the course of its trade or business during the calendar year. It must report interest payments if they total \$10 or more.

For example, if the partnership pays a person \$600 or more in any calendar year to perform services under a subcontract type of arrangement in which no employment taxes are withheld, the partnership must file federal Form 1099-MISC, Miscellaneous Income.

Use Form N-196, Annual Summary and Transmittal of Hawaii Information Returns, to summarize and send information returns to your respective taxation district office. For more information about filing information returns and exceptions, see the instructions for Form N-196.

Attachments

If you need more space on the forms or schedules, attach separate sheets. Use the same arrangement as the printed forms. **Show the totals on the printed forms.** Put the partnership's name and Federal Employer Identification Number on each sheet. Also, be sure that each separate sheet clearly indicates the line or section on the printed form to which the information relates.

To assist us in processing the return, please complete every applicable entry space on Form N-20. Do not attach statements and do not write "See attached" in lieu of completing the entry spaces on the form.

Definitions

a. Partnership. The term "partnership" includes a limited partnership, syndicate, group, pool, joint venture, or other unincorporated organization, through or by which any business, financial operation, or venture is carried on, and that is not, within the meaning of the federal Internal Revenue Code, a corporation, trust, estate, or sole proprietorship. If an organization more nearly resembles a corporation than a partnership or trust, it is considered an association taxed as a corporation.

Important factors in determining whether a partnership exists include:

1. The parties' conduct in carrying out the provisions of the partnership agreement;
2. The testimony of disinterested persons;
3. The relationship of the parties;
4. The abilities and contributions of each; and
5. The control each has over the partnership income and the purposes for which the income is used.

A joint undertaking merely to share expenses is not a partnership. Mere co-ownership of property that is maintained and leased or rented does not constitute a partnership. However, if the co-owners provide services to the tenants, a partnership exists.

Some partnerships **may be** excluded completely or partially for being treated as partnerships for federal income tax purposes upon the election of all of the members. See **Specific Instructions** on page 3 for more information.

b. General Partner. A general partner is a member of the organization who is personally liable for the obligations of the partnership.

c. Limited Partner. A limited partner is one whose potential personal liability for partnership debts is limited to the amount of money or other property that the partner contributed or is required to contribute to the partnership.

d. Limited Partnership. A limited partnership is a partnership composed of at least one general partner and one or more limited partners.

e. Nonrecourse Loan. Nonrecourse loans are those liabilities of the partnership for which none of the partners have any personal liability.

Separately Stated Items

Partners are required to take into account separately (under section 702(a)) their distributive shares of the following items (whether or not they are actually distributed):

1. Ordinary income or loss from trade or business activities;
2. Net income or loss from rental estate activities;
3. Net income or loss from other rental activities;
4. Gains and losses from sales or exchanges of capital assets;
5. Gains and losses from sales or exchanges of property described in section 1231;
6. Charitable contributions;
7. Dividends (passed through to corporate partners) that qualify for the dividends-received deduction;
8. Other items of income, gain, loss, deduction, or credit, to the extent provided by regulations. Examples of such items include nonbusiness expenses, intangible drilling and development costs, and soil and water conservation expenditures.

Elections

Generally, the partnership decides how to figure taxable income from its operations. For example, it chooses the accounting method and depreciation methods it will use. The partnership also makes the elections under the following IRC sections:

- Section 179 (election to expense certain tangible property);
- Section 614 (definition of property—mines, wells, and other natural deposits. This election must be made before the partners compute their individual depletion allowances under section 613A(c)(7)(D));
- Section 754 (manner of electing optional adjustment to basis of partnership property).

Under section 754, a partnership may elect to adjust the basis of partnership property when property is distributed or when a partnership interest is transferred. If the election is made with respect to a transfer of a partnership interest (section 743(b)) and the assets of the partnership constitute a trade or business for purposes of section 1060(c), then the value of any goodwill transferred must be determined in the manner provided in Temporary Regulations section 1.1060-1T. Once an election is made under section 754, it applies both to all distributions and to all transfers made during the tax year and in all subsequent tax years unless the election is revoked (see Regulations section 1.754-1(c)).

This election must be made in a statement that is filed with the partnership's timely filed return (including any extension) for the tax year during which the distribution or transfer occurs. The statement must include **(a)** the name and address of the partnership; **(b)** a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b); and **(c)** the signature of the general partner authorized to sign the partnership return.

See section 754 and the related regulations for more information.

Note: If there is a distribution of property consisting of an interest in another partnership, see section 734(b).

- Section 1033 (involuntary conversions).

Elections under the following Code sections are made by each partner separately on the partner's tax return:

- Section 108 (income from discharge of indebtedness); and
- Section 617 (deduction and recapture of certain mining exploration expenditures paid or incurred).

Partner's Dealings With Partnership

If a partner engages in a transaction with his or her partnership, other than in his or her capacity as a partner, the partner is treated as not being a member of the partnership for that transaction. Special rules apply to sales or exchanges of property between partnerships and certain persons, as explained in federal Publication 541.

Distribution of Unrealized Receivables and Inventory Items

If a partnership distributes unrealized receivables or substantially appreciated inventory items for all or part of a partner's interest in other partnership property (including money), treat the transaction as a sale or exchange between the partner and partnership. Treat the partnership gain (loss) as ordinary income (loss). Allocate it only to partners (other than the distributee partner) who will take this amount into account separately under section 702(a)(7). If a partnership gives other property (including money) for all or part of that partner's interest in the partnership's unrealized receivables or substantially appreciated inventory items, treat the transaction as a sale or exchange of the property. See section 751 and related regulations for definitions of unrealized receivables and substantially appreciated inventory items.

Net Operating Loss Deduction

A partnership is not allowed the deduction for net operating losses. (See section 703(a)(2)(E).)

Contributions to the Partnership

Generally, no gain (loss) is recognized to the partnership or any of the partners when property is given to the partnership in exchange for an interest in the partnership. This rule does not apply to any gain realized on a transfer of property to a partnership that would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated.

The basis to the partnership of property given by a partner is the adjusted basis in the hands of the partner at the time it was given, plus any gain recognized at that time. (See section 723.)

Dispositions of Contributed Property

If the partnership disposes of property contributed to the partnership by a partner, income, gain, loss, and deductions from that property must be allocated among the partners to take into account the difference between the property's basis and its fair market value at the time of the contribution.

For property contributed to the partnership after October 3, 1989, the contributing partner must recognize gain or loss on a distribution of the property to another partner within 5 years of being contributed. The gain or loss is equal to the amount that the contributing partner should have recognized if the property had been sold for its fair market value when distributed, because of the difference between the property's basis and its fair market value at the time of contribution.

See section 704(c) for details and other rules on dispositions of contributed property.

See section 724 for the character of any gain or loss recognized on the disposition of unrealized receivables, inventory items, or capital loss property contributed to the partnership by a partner.

Passive Activity Limitations

See the instructions for federal Form 1065 for a discussion of passive activity limitations.

Signatures

General Partner

Form N-20 is not considered a return unless it is signed. One general partner must sign the return. If a receiver, trustee in bankruptcy, or assignee controls the organization's property or business, that person must sign the return.

Paid Preparer's Information

If someone prepares the return and **does not charge the partnership**, that person should not sign the partnership return.

Generally, anyone who is paid to prepare the partnership return must sign the return and fill in the other blanks in the **Paid Preparer's Information** area of the return.

The preparer required to sign the partnership's return MUST complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps or labels are not acceptable.)
- Give the partnership a copy of the return in addition to the copy to be filed with your taxation district office.

Specific Instructions

These instructions follow the line numbers on the first page of Form N-20 and on the schedules that accompany it. Specific instructions for most of the lines have been provided. Those lines that do not appear in the instructions are self-explanatory.

File only one return for each partnership. Mark "duplicate copy" on any copy you give to a partner.

If a syndicate, pool, joint venture, or similar group files Form N-20, a copy of the agreement and all amendments must be attached to the return, unless a copy has already been filed. Under section 761(a), an investing unincorporated organization or one participating in the joint production, extraction, or use of property under an operating agreement or an organization of dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities may elect not to be treated as a partnership. Make the election by attaching a statement to Form N-20 for the first year for which the partnership wants the exclusion.

Fill in applicable lines and schedules.

Form N-20

Name, Address, Hawaii G.E./Use Identification Number and Federal Employer I.D. Number

The partnership may use its legal or trade name on all tax returns and other documents filed. Print or type the partnership's legal name and address on the appropriate line. Show the Hawaii G.E./Use Identification Number in item F and the Federal

Employer I.D. Number in item E on page 1 of Form N-20.

Lines 1a and 1b

Enter gross receipts or sales from all business operations and returns and allowances. Do not include those you are required to report on lines 4 through 7.

Line 2

Complete Schedule A of Form N-20 if there is an entry on line 2 for cost of goods sold.

Line 4

Enter the amount shown on Form N-20, Schedule K-1, or Form N-40, Schedule K-1.

Show the other partnership's or fiduciary's name, address, and Federal Employer's Identification Number on a separate statement attached to this return. If income or loss from more than one entity is reported on this line (or is reported instead on another line or schedule of this Form N-20), show on the statement the income or loss from each.

If there is a loss from another partnership, the amount of the loss that may be claimed is subject to the limitations of sections 465 and 704(d), as appropriate.

Example: If partnership A is a partner in Partnership B, Partnership A enters on this line its share of ordinary income (loss) of B. This information should be shown on the Schedule K-1 that B issued to Partnership A.

If A's tax year does not coincide with B's tax year, include in A's return the share of the ordinary income (loss) for the tax year of B ending within the year for which A's return is filed.

Partnership A considers its share of other items separately reported on the Schedule K-1 issued by B as if the items were realized by B or incurred in the same manner as incurred by B. For example, Partnership A's share of B's capital gains (losses) should be reported on Schedule D of Form N-20, lines 4 and 9.

Line 5

Enter the net profit (loss) derived from the farm operations of the partnership. Attach Schedule F.

Line 6

Caution: *Include only ordinary gains or losses from the sale, exchanges, or involuntary conversion of assets used in a trade or business activity. Ordinary gains or losses from the sale, exchange, or involuntary conversion of rental activity assets will be reported separately on Schedules K and K-1, generally as a part of the net income (loss) from the rental activity. If the partner does not materially participate in the trade or business, the gains or losses reported on line 6 will be subject to the passive activity rules.*

Line 7

Enter any other taxable income and attach a detailed schedule to return. Include taxable income from annuities and insurance proceeds.

Do not include those items requiring separate computations which must be reported on Schedule K. (See the instructions for Schedule K.)

Organization and Syndication Expenses

Amounts paid or incurred to organize a partnership or promote the sale of an interest in a partnership are capital expenditures subject to section 263. They are not deductible. Under section 709, the partnership may choose to amortize the organization expenses over a period of 60 or more months,

beginning with the month in which the partnership begins business. (See the instructions for line 20.) On the balance sheet (Schedule L) show the unamortized balance of organization costs and all syndication expenditures. See the note in the instructions for line 10 for the treatment of these amounts paid to a partner.

Lines 9a, 9b, and 9c

Enter salaries and wages not reported elsewhere (for example, Schedule A, line 3, and contributions to Simplified Employee Pension plans (SEP's) line 18) and reduce it by jobs credit on Schedule K, line 17.

Line 10

Deduct payments or credits to a partner for services or for the use of capital if the payments or credits are determined without regard to partnership income. Do not do this if the payments and credits should be capitalized. Do not include distributive shares of partnership profits. Report the guaranteed payments to the appropriate partners on Schedule K-1 (Form N-20), line 5.

Note: *Although payments or credits to a partner for services rendered in organizing a partnership may be guaranteed payments under section 707, they are not deductible on line 10. But they should be separately reported on Schedules K and K-1, line 5. They are capital expenditures.*

Line 11

Enter the cost of incidental repairs, such as labor and supplies, that do not add to the value of the property or appreciably prolong its life. New building, machinery, or permanent improvements that increase the value of the property are not deductible. They are chargeable to capital accounts and may be depreciated or amortized.

Do not include section 179 expense items. Report this amount on Form N-164, Part I, Section A and on Schedule K, line 9.

Line 12

You may either deduct business bad debts when they become wholly or partially worthless. The Tax Reform Act of 1986 repealed the reserve method of deducting bad debts on receivables, except for small banks and thrift institutions. Effective for tax years beginning after 1986, taxpayers will have to use the specific charge-off method for receivables that become uncollectible in whole or in part.

Line 13

Enter rent paid on business property. Do not deduct rent for a dwelling unit occupied by any partners for personal use.

Line 14

Enter taxes paid or incurred on business property for carrying on a trade or business property for carrying on a trade or business, if not reflected in cost of goods sold. Federal import duties and federal excise and stamp taxes are deductible only if paid or incurred in carrying on the trade or business of the partnership. Taxes incurred in the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income may be considered to be deductible only under section 212. These are not deductible on line 14, but are reportable separately to the partners on Schedule K and K-1, line 11, as an itemized deduction. Do not deduct taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.), federal income taxes, estate, inheritance, legacy, succession, and gift

taxes, or taxes reported elsewhere, as on federal Form 8825 or Schedule K.

Do not deduct amounts paid or accrued during the year for real property construction period taxes (other than for low-income housing). See the instructions for line 20 for information on amortizing these amounts.

Line 15

Caution: Investment interest expense that is reported on Schedule K, line 18a is not deductible by the partnership and should not be included on line 15.

Generally, interest expense on funds borrowed to purchase or carry property held for investment is not deducted on line 15. Instead, it is reported on Schedule K, line 18a. (See the instructions for Schedule K, line 18a.) If any of this amount is nonbusiness interest, notify the partners as to the amount. For more information, see section 163(d) and **Form N-158**, Investment Interest Expense Deduction.

Also, do not deduct amounts paid or accrued during the year for real property construction period interest (other than for low-income housing). See the instructions for line 20 for information on amortizing these amounts. However, you may deduct amounts paid or accrued during the year for non-residential real property construction period interest if the construction period began in a tax year beginning before January 1, 1976. (See section 189 for definitions.)

Enter interest on all indebtedness incurred for the operation of the trade or business of the partnership. Payments or credits by a partnership to a partner for the use of capital should be entered on line 10. But interest paid by a partnership to a partner as a result of a transaction in which the partner acts as other than a partner, should be entered on line 15 unless it is investment interest. (See caution above.) This interest is also reported on federal Form 1099-INT, Interest Income, if over \$10. (The limitations on deductions for unpaid interest are in federal Regulations 1.267(b)-1(b).)

Generally, both accrual and cash basis partnerships must deduct prepaid interest payments over the period of the prepayment instead of when actually paid. (See section 461(g).)

Line 16

Enter the total amount of depreciation claimed. Complete and attach federal **Form 4562**. See federal Form 4562 and the related instructions for more information.

Do not include any expense deduction for recovery property (section 179) on this line. This amount is not deductible by the partnership. Instead, it is passed through to the partners on line 9 of Schedules K and K-1.

Line 17

If the partnership claims a deduction for timber depletion, complete and attach federal Form T, Forest Industries Schedule.

Do not report depletion deductions for oil and gas properties on this line. Each partner figures depletion on these properties under section 613A(c)(7)(D).

Line 18

Enter deductible contributions made by the partnership for its common-law employees under a qualified pension, profit-sharing, annuity, bond purchase plan, or Simplified Employee Pension plan (SEP), and under any other deferred compensation plan. Enter payments made to these plans for partners on Schedules K and K-1, line 11.

If the partnership contributes to an Individual Retirement Arrangement (IRA) for employees, include the contribution in compensation on page 1, line 9, or Schedule A, line 3, not on line 18. Enter contributions to an IRA for a partner on Schedules K and K-1, line 11.

Line 19

Enter the partnership's contributions to employee benefit programs for common-law employees which are not part of retirement plans included on 18, such as contributions for insurance, health, and welfare programs.

Do not include any deductions allowable under the provisions of section 162(m) with respect to amounts paid during the taxable year for insurance which constitutes medical care for a partner, a partner's spouse, or partner's dependents.

Line 20

Other Deductions

Enter any other authorized deductions related to a trade or business activity for which there is no line on page 1 of Form N-20.

Do not include those items requiring separate computation that must be reported on Schedule K-1.

Do not include qualified expenditures to which an election under section 59(e) applies.

Note for travel and entertainment expenses: *Generally the amount allowable to the partnership as a deduction for meal and entertainment expenses is limited to 80% of the amount that would otherwise be allowable as a deduction. This limitation (section 274(n)) generally is applied after determining the amount of the otherwise allowable deduction under section 162, which permits a deduction for ordinary and necessary expenses, and other provisions of section 274 which disallow a deduction for certain entertainment expenses.*

Expenditures for meals or beverages are disallowed to the extent that they are lavish or extravagant.

Because of the phase-in provision of section 274(l)(2), skybox rental expense will generally have to be separately stated on line 11 of Schedules K and K-1. See the instructions for line 11 of Schedules K and K-1 for more information on skybox expense.

The rules for deductible expenses for luxury water travel, convention expenses, and tickets for entertainment have also been changed. For example, no deduction is allowed for travel, meals, and lodging expense incurred in connection with attending an investment seminar or similar meeting. The deduction formerly allowable under section 212 for such expenses is repealed. The partnership cannot deduct or pass through to partners these expenses.

Also the partnership may not deduct any expense paid or incurred for a facility (such as a yacht or hunting lodge) that is used for an activity that is usually considered entertainment, amusement, or recreation. (The partnership may be able to deduct the expense if the amount is treated as compensation and reported on Form HW-2 for an employee or on federal Form 1099-MISC for an independent contractor.)

See federal Publication 463, Travel, Entertainment, and Gift Expenses, and federal Publication 917, Business Use of a Car for more details.

Amortization. Include on line 20, the amount from federal Form 4562. If the partnership elects the deduction for amortization of certain expenditures for research and experiments (section 174), trademark and trade name (section 177), or mine or natural deposit development (section 616), file a statement with the return.

If the partnership owns a certified historic structure and pays or incurs certain capital expenditures to rehabilitate it, special rules apply.

See section 169 for amortization of pollution control facilities.

See section 194 for amortization of forestation or reforestation expenditures.

See section 195 for amortization of startup expenditures.

See section 188 for amortization of certain expenditures for on-the-job training facilities and for child-care facilities.

See section 709 for amortization of the cost of partnership organization expenses over a period of 60 or more months.

See section 189(b) for amortization of real property construction period interest and taxes, other than for low-income housing.

Schedule A

Cost of Goods Sold

Line 1

Enter the beginning inventory on Schedule A, line 1. If it is different from last year's closing inventory, attach an explanation.

Line 2

Include withdrawals for personal use in Schedules M-2 and K-1 (Item J) as distributions to partners.

Line 9

Your inventories can be valued at:

- cost,
- cost or market value (whichever is lower), or
- any other method approved by the Director of Taxation, when those methods conform with the provisions of the Hawaii Revised Statutes.

Check the method(s) used for valuing inventories on line 9a. Under "lower of cost or market," market generally applies to normal market conditions when there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For additional requirements, see federal Regulations section 1.471-4.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of federal Regulations section 1.471-2(c). Such goods may be valued at a current bona fide selling price minus the direct cost of disposition (but not less than scrap value) if the taxpayer can establish such a price. See federal Regulations section 1.471-2(c) for additional requirements.

On line 9a(iv), indicate whether you used a method of inventory valuation other than those described in line 9a(i), (ii), or (iii), and attach a statement describing the method used.

If this is the first year the "Last-in First-out" (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method, provided in section 472, attach a statement with an explanation.

Schedule B

Additional Information Required

Answer all questions listed in this schedule.

Schedule D

Capital Gains and Losses

Purpose of Schedule.—Use Schedule D (Form N-20) to report the sale or exchange of capital assets, except capital gains (losses) that are specially allocated to any partners.

FOR DETAILED INFORMATION SEE
SEPARATE INSTRUCTIONS FOR
SCHEDULE D (FORM N-20).

Schedule K and Schedule K-1

Partners' Share of Income, Credits, Deductions, etc.

Purpose

Schedule K is a summary schedule of all the partners' shares of the partnership's income, deductions, credits, etc. Prepare Schedule K-1 in triplicate. A copy of each partner's K-1 must be attached to the Form N-20 filed with your taxation district office, one copy to be sent to each partner, and one copy retained for the partnership's files.

Although the partnership is not subject to income tax, the members are liable for income tax on their shares of the partnership income, whether or not distributed, and must include their share on their returns.

The total amount of the distributive share items (columns b and c) reported on each line on all of the partners' Schedules K-1 should equal the amount reported on the same line of Schedule K of Form N-20. Similarly, the total of the amounts reported in column (g) of item J of all the partners' Schedules K-1 should equal the amount reported on line 9 in Schedule M-2 of Form N-20.

Complete Schedule K-1 for each partner. Schedules K and K-1 have the same line numbers to make it easier for the partnership to prepare Schedule K-1. In addition, Schedule K-1 has questions A thru I and item J. Additional copies of Schedule K-1 are available from your taxation district office.

Attributable to Hawaii

Each partnership must state specifically the income attributable to the State and the income attributable everywhere with respect to each partner.

Ordinary income or (loss) from trade or business activities shall be attributed to the State by the use of the apportionment of business income allocation provisions of the Uniform Division of Income for Tax Purposes Act (UDITPA), section 235-29, HRS. Business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three. The property factor is a fraction, the numerator of which is the average value of the partnership's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all the partnership's real and tangible personal property owned or rented and used during the tax period. Property owned by the partnership is valued at its original cost. Property rented by the partnership is valued (or capitalized) at eight times the net annual rental rate. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period. The use of monthly values may be required if necessary to properly reflect the average value of the partnership's property. The payroll factor is a fraction, the numerator of which is the total amount paid

in this State during the tax period by the partnership for compensation, and the denominator of which is the total compensation paid everywhere during the tax period. The sales (or gross receipts) factor is a fraction, the numerator of which is the total sales of the partnership in this State during the tax period, and the denominator of which is the total sales of the partnership everywhere during the tax period.

If this apportionment does not fairly represent the extent of the partnership's business activity in this State, the partnership may request the use of separate accounting, the exclusion of one or more of the factors, the inclusion of one or more additional factors, or the use of any other method to accurately reflect the partnership's business activity in the State. Complete Schedules O and P on page 4 of Form N-20 to show this computation.

Other items are attributed as follows:

- Net rents and royalties from real property located in Hawaii are attributed to Hawaii. Federal Form 8825 may be attached to Form N-20 as a schedule of expenses.
- Net rents and royalties from tangible personal property are attributed to Hawaii if and to the extent that the property is utilized in Hawaii.
- Capital gains and losses from sale of real property located in Hawaii are attributed to Hawaii.
- Capital gains and losses from sales of tangible personal property are attributable to Hawaii if the property had a situs in Hawaii at the time of the sale.
- Interest and dividends are attributed to Hawaii if the partnership's commercial domicile is in Hawaii.
- Patent and copyright royalties are attributed to Hawaii if and to the extent that the patent or copyright is utilized by the payer in Hawaii.

How Income is Shared Among Partners

Income (loss) is allocated to a partner only for the part of the year in which that person is a member of the partnership. The partnership will either allocate on a daily basis or divide the partnership year into segments and allocate income, loss, or special items in each segment among the persons who were partners during that segment. (See section 706(c)(2) for more information and for the termination of a partner's interest.)

Allocate shares of income, gain, loss, deduction, or credit among the partners according to the partnership agreement for sharing income or loss generally. If the partners agree, specific items may be allocated among them in a ratio different from the ratio for sharing income or loss generally. For instance, if the net income exclusive of specially allocated items is divided evenly among three partners but some special items are allocated 50% to one, 30% to another, and 20% to the third partner, report the special items on the appropriate line of the applicable partner's Schedule K-1 and the total on the appropriate line of Schedule K instead of on the numbered lines on page 1 of Form N-20 or Schedules A or D.

If the partnership agreement does not provide for the partner's share of income, gain, loss, deduction, or credit, or if the allocation under the agreement does not have the substantial economic effect, the partner's share is determined according to the partner's interest in the partnership. (See section 704(b).)

Specific Instructions

(Schedule K only)

Enter the total distributive amount for each applicable items listed.

(Schedule K-1 only)

Prepare and give a Schedule K-1 to each person who was a partner in the partnership at any time during the year. **Schedule K-1 must be provided to each partner on or before the day on which the partnership return is required to be filed.**

Note: Generally, any person who holds an interest in a partnership as a nominee for another person is required to furnish to the partnership the name, address, etc., of the other person.

On each Schedule K-1, enter the names, addresses, and identifying numbers of the partner and partnership and the partner's distributive share of each item.

For an individual partner, enter the partner's social security number. For all other partners, enter the partner's Federal Employer Identification Number. (However, if a partner is an individual retirement arrangement (IRA), enter the identifying number of the custodian of the IRA. Do not enter the social security number of the person for whom the IRA is maintained.)

If a husband and wife each had an interest in the partnership, prepare a separate Schedule K-1 for each of them. If a husband and wife held an interest together, prepare one Schedule K-1 if the two of them are considered to be one partner.

Note: Space has been provided after line 19 of Schedule K-1 for you to provide information to the partners. This space may be used in lieu of attachments.

Question A.—Is this partner a General Partner?

Question A must be answered for all partners. If a partner holds interests as both a general and limited partner, attach a schedule for each activity which shows the amounts allocable to the partner's interest as a limited partner.

Item B.—Partner's Share of Liabilities.

Enter each partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities. If the partner terminated his or her interest in the partnership during the year, enter the share that existed immediately before the total disposition. In all other cases, enter it as of the end of the year.

If the partnership is engaged in two or more different types of "at risk" activities, or a combination of "at risk" activities and any other activity, attach a statement showing the partner's share of nonrecourse liabilities, partnership-level qualified nonrecourse financing, and other liabilities for **each** activity. See sections 465(c)(2) and (3) to determine if the partnership is engaged in more than one "at risk" activity.

If a partnership is engaged in an activity subject to the limitations of section 465(c)(1), give each partner his or her share of the total pre-1976 losses from the section 465(c)(1) activity (i.e., film or video tape, section 1245 property leasing, farm, or oil and gas property) for which there existed a corresponding amount of nonrecourse liability at the end of each year in which the losses occurred.

Question C.—What Type of Entity is This Partner? State on this line whether the partner is an individual, a corporation, a fiduciary, a partnership, an exempt organization, or a nominee. If the partner is a nominee, indicate the type of entity the nominee represents: I—Individual; C—Corporation; F—Fiduciary; P—Partnership; E—Exempt Organization; or IRA—Individual Retirement Arrangement.

Question D.—Partner's Profit, Loss, and Capital Sharing Percentages. Enter in item D(ii) the percentage existing at the end of the year. How-

ever, if a partner's interest terminated during the year, enter in item D(i) the percentages that existed immediately before the termination. When the profit or loss sharing percentage has changed during the year, show the percentage before the change in item D(i) and the end of year percentage in item D(ii). If there are multiple changes in the profit and loss sharing percentage during the year, attach a statement giving the date and percentage before each change. "Ownership of capital" means the portion of the capital that the partner would receive if the partnership was liquidated at year end by the distribution of undivided interests in partnership assets and liabilities.

Items F and G.—Federal Tax Shelter Registration Information. If the partnership is a registration-required tax shelter, it must enter its Federal Tax Shelter Registration Number in Item F and identify the type of tax shelter in the space provided in Item G. If the partnership invested in a registration-required shelter, the partnership must also attach a copy of federal Form 8271 to Schedule K-1. See federal Form 8271 for a list of the types of tax shelters and for more information.

Question J. Reconciliation of Partner's Capital Account. See page 7 of instructions for both "Filing a Complete Return" and Schedule M-2.

(Schedules K and K-1 unless otherwise noted)

Income (loss)

Line 1

Enter the partner's share of the ordinary income (loss) reported on Form N-20, line 21. If line 21 is a loss, enter the partner's full share of the loss. If the partner holds interests in the partnership both as a general partner and as a limited partner, enter the total loss for all interests held in the partnership. Enter the loss without reference to the adjusted basis of the partner's interest in the partnership or the partner's amount at risk. Line 1 should reflect the total ordinary income (loss) from all trade or business operations.

Line 5

Enter: (1) the guaranteed payments to partners for salaries and interest deducted by the partnership and reported on Form N-20, line 10; and (2) the guaranteed payments to partners that the partnership is required to capitalize. (See the note in the instructions for Form N-20, line 10.)

Line 6

Give each partner a schedule that separately shows each partner's share of the amount to be reported on federal Form 4684, Casualties and Thefts.

Line 7

Enter any other items of income, gain, or loss not included on lines 1-6, such as:

- Gains from the disposition of farm recapture property (see Schedule D-1) and other items to which section 1252 apply.
- Recoveries of bad debts, prior taxes, and delinquency amounts (section 111).
- Gains and losses from wages (section 165(d)).
- Any income, gain, or loss to the partnership under section 751(b).

Deductions

Line 8

Enter the total amount of charitable contributions, and each amount subject to the 50%, 30%, and 20% limitations paid by the partnership during the tax year. Attach an itemized list that separately shows the partnership's charitable contributions subject to the 50%, 30%, and 20% limitations.

If the partnership made a qualified conservation contribution under section 170(h), also include the fair market value of the underlying property before and after the donation, the type of legal interest contributed, and describe the conservation purpose furthered by the donation. Give a copy of this information to each partner.

Line 9

A partnership may elect to expense part of the cost (up to \$17,500) of recovery property that the partnership purchased this year for use in its trade or business. The partnership may not deduct the section 179 expense, but should report the expense separately on Schedules K and K-1. The partners report their shares in the year in which the property is placed in service. Show the total section 179 expense on Schedule K, line 9, and allocate it to each partner on Schedule K-1, line 9.

The partnership must specify the item(s) of section 179 property which it elects to treat as an expense and the portion of the cost of each item which is being treated as an expense. Do this on federal Form 4562, Depreciation and Amortization, and on a schedule attached to Schedule K-1. Generally, any election made under section 179 may not be revoked except with the consent of the Director.

Depreciation or amortization may **not** be taken on any amount for which a deduction is allowed under section 179.

See section 179 and federal Form 4562 for more information.

Line 11

Enter any other deductions not included on line 8-10, such as:

- Amounts, other than investment interest, paid by the partnership that would be itemized deductions on any of the partners' income tax returns if they were paid directly by a partner for the same purpose. These amounts include, but are not limited to expenses under section 212 for the production of income other than from the partnership's trade or business.
- Any interest penalty on early withdrawal of savings. The federal Form 1099-INT given to the partnership by a bank or savings and loan association will show the amount of any interest penalty the partnership was charged because it withdrew funds from its time savings deposit before its maturity.
- Soil and water conservation expenditures (section 175).
- Deduction and recapture of certain mining exploration expenditures paid or incurred (section 617).
- Intangible drilling costs.

Credits

Line 12

Energy Conservation Tax Credit

On Schedule K enter the tax credit for solar or wind energy devices, heat pumps and ice storage systems computed by the partnership. This credit is computed at the partnership level. It is apportioned among the partners according to their interest in the

partnership. On Schedule K-1 enter each partner's share of the credit.

Line 13

Total Cost of Qualifying Property for the Capital Goods Excise Tax Credit

A Capital Goods Excise Tax Credit is available for tangible personal property purchased and used in a trade or business in Hawaii. The amount of the tax credit allowable is 4% of the cost of the qualified tangible property. The tax credit is applied against a taxpayer's net income tax liability and if the tax credit exceeds the amount of the tax liability, the excess will be refunded to the taxpayer. See Form N-312A, Capital Goods Excise Tax Credit, for additional information.

Line 14

Fuel Tax Credit for Commercial Fishers

Enter the fuel tax credit for commercial fishers as determined by Form N-163A.

Line 15

Enterprise Zone Tax Credit

Enter the amount of the credit as determined by Form N-756.

A qualified enterprise zone business is eligible to claim a credit for a percentage of taxes due the State attributable to the conduct of business within a zone and a percentage of the amount of unemployment insurance premiums paid based on the payroll of employees employed at the business firm establishments in the zone. The applicable percentage is 80% the first year; 70% the second year; 60% the third year; 50% the fourth year; 40% the fifth year; 30% the sixth year; and 20% the seventh year. This credit is not refundable and any unused credit may NOT be carried forward. Attach Form N-756, Enterprise Zone Tax Credit, to support your claim for this credit.

Line 16

Low-Income Housing Tax Credit

Hawaii's low-income housing tax credit is equal to 30% of the federal credit for qualified buildings located in the State of Hawaii. The federal credit must be claimed in order to claim the Hawaii credit. Attach Form N-586, Tax Credit for Low-Income Housing, to the partnership return.

Contact the Housing Finance Development Corporation for qualifying requirements and further information.

Line 17

Credit for Employment of Vocational Rehabilitation Referrals

The amount of the tax credit for the taxable year shall be equal to 20 percent of the qualified first-year wages for that year. The amount of the qualified first-year wages which may be taken into account with respect to any individual shall not exceed \$6,000.

"Qualified wages" means the wages paid or incurred by the employer during the taxable year to an individual who is a vocational rehabilitation referral and more than one-half of the wages paid or incurred for such an individual is for services performed in a trade or business of the employer.

"Qualified first-year wages" means, with respect to any vocational rehabilitation referral, qualified wages attributable to service rendered during the one-year period beginning with the day the individual begins work for the employer.

The credit allowed shall be claimed against net income tax liability for the taxable year. A tax credit which exceeds the taxpayer's income tax liability may be used as a credit against the taxpayer's income tax liability in subsequent years until exhausted.

Refer to Form N-884 for further information.

Investment Interest

Line 18

Line 18a-18b(2) must be completed whether or not a partner is subject to the investment interest rules.

Line 18a. Investment Interest Expense.—Include on this line interest paid or accrued to purchase or carry property held for investment. Property held for investment includes property that produces portfolio income (interest, dividends, annuities, royalties, etc.). Therefore, interest expense allocable to portfolio income should be reported on line 18a of Schedule K-1 (rather than line 10 of Schedule K-1).

Property held for investment includes a partner's interest in a trade or business activity that is not a passive activity to the partner and in which the partner does not materially participate. An example would be a partner's working interest in oil and gas property (i.e., the partner's interest is not limited) if the partner does not materially participate in the oil and gas activity.

Investment interest does not include interest expense allocable to a passive activity.

The amount on line 18a will be deducted (after applying the investment interest expense limitations of section 163(d) by individual partners on their Form N-12 or N-15.

Lines 18b(1) and 18b(2). Investment Income and Expenses.—Enter on line 18b(1) only the investment income included on line 4 of Schedule K-1. Enter on line 18b(2) only the investment expense included on line 10 of Schedule K-1.

If there are items of investment income or expense included in the amounts that are required to be passed through separately to the partner on Schedule K-1 (items other than the amounts included on lines 4 and 10 of Schedule K-1), give each partner a schedule identifying these amounts.

Investment income includes gross income from property held for investment, gain attributable to the

disposition of property held for investment, and other amounts that are gross portfolio income. Investment income and investment expenses do not include any income or expenses from a passive activity.

Property subject to a net lease is not treated as investment property because it is subject to the passive loss rules. Do not reduce investment income by losses from passive activities.

Investment expenses are deductible expenses (other than interest) directly connected with the production of investment income.

Other

Line 19

If applicable, include a schedule listing each partner's share of: (1) the total taxes withheld under the partnership's name and reported on Form N-288A, Statement of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interests; (2) any refunds claimed by the partnership on Form N-288C, Application for Tentative Refund of Withholding on Dispositions by Nonresident Persons of Hawaii Real Property Interest; and (3) the net amount of taxes withheld.

Analysis (Schedule K only)

Lines 20a and 20b

For each type of partner shown, enter the portion of the amount shown on line 20a of Schedule K that was allocated to that type of partner. The sum of the amounts shown on line 20b must equal the amount shown on line 20a. In addition, the amount on line 20a must equal the amount on line 9, Schedule M-1 (if the partnership is required to complete Schedule M-1).

In classifying partners who are individuals as "active" or "passive," the partnership should apply the following rules:

1. If the partnership's principal activity is a trade or business activity, classify a general partner as "active" if the partner materially participated in all partnership trade or business activities; otherwise, classify a general partner as "passive."
2. If the partnership's principal activity consists of working interest in an oil or gas well, classify a partner holding a working interest in the oil or gas well through an entity that does not limit the

partner's liability as "active;" otherwise, classify the partner as "passive."

3. If the partnership's principal activity is a rental real estate activity, classify a general partner as "active" if the partner actively participated in all of the partnership's rental real estate activities; otherwise, classify a general partner as "passive."
4. If the partnership's principal activity is a portfolio activity, classify all partners as "active."
5. Classify all limited partners and all partners in a partnership whose principal activity is a rental activity other than a rental real estate activity as "passive."
6. If the partnership cannot make a reasonable determination as to whether or not a partner's participation in a trade or business activity is material or whether or not a partner's participation in a rental real estate activity is active, classify the partner as "passive."

In applying the above rules, a partnership should classify each partner to the best of its knowledge and belief. It is assumed that in most cases the level of a particular partner's participation in an activity will be apparent.

Filing a Complete Return

You will be considered to have filed a complete return, and are **not** required to furnish Schedules L, M-1, and M-2, on page 4 of Form N-20, and item J on Schedule K-1 if you are not required to file such schedules with the federal Form 1065.

If you are not furnishing Schedules L, M-1, and M-2 because the partnership meets **ALL** of the tests prescribed by the federal Form 1065, check the appropriate box on page 4, Form N-20.

Schedules L, M-1, and M-2 (Form N-20)

Attach a copy of page 4 of federal Form 1065 to the partnership's Hawaii return (Form N-20).

Schedules O and P

Apportionment of Income Computation of Apportionment Factors

See the instructions for "Attributable to Hawaii" on page 5, under **Schedule K and Schedule K-1**.